CHAPTER 1
Strategic Leadership: Managing the Strategy-Making Process for Competitive Advantage

Synopsis of Chapter

This chapter is an introductory chapter. Its purpose is to define critical concepts and introduce the main components of the strategic leadership and management process. This chapter serves to establish the context within which subsequent chapters fit.

Chapter 1 begins with a discussion of the concept of strategy. The strategies an organization pursues have a major impact upon its performance relative to its peers. The firm's top managers have direct responsibility for choosing strategies that will lead to superior performance and provide competitive advantage.

Next, the chapter equates superior performance with profitability, for profit-seeking enterprises. Sustained competitive advantage occurs when a firm is able to maintain above average profitability over an extended period of time. Strategic management is just as crucial to nonprofits as it is to profit-seeking businesses. Much of this book is about identifying and describing the strategies that managers can pursue to achieve superior performance and provide their company with a competitive advantage. The book will provide a thorough understanding of the business model analytical techniques and skills necessary to identify and implement strategies successfully.

A discussion of strategic managers and the strategy-making process follows. Strategic managers are the linchpin in the strategy-making. Strategy-making is the process by which managers formulate and implement a set of strategies for a company, the aim of which is to attain competitive advantage. It examines the types of strategic managers, their roles and their responsibilities at three main levels within an organization—corporate, business, and functional. This chapter also gives an overview of the formal strategic management process. The process consists of two phases. The first phase, formulation, includes the establishment of corporate mission, values, and goals; analysis of the external environment; analysis of the internal environment; and selection of an appropriate functional-, business-, global, or corporate-level strategy. The second phase, implementation, consists of the actions taken to carry out the chosen strategy such as appropriate governance and ethics, designing an organizational structure, designing an organization culture, and designing organization controls.

The traditional concept of the strategic planning process is one that is rational and deterministic, and orchestrated by senior managers. However, strategies may also emerge through other mechanisms.

The next section of this chapter presents a discussion of strategic planning in practice. Formal planning helps companies make better strategic decisions, and the use of decision aids can help managers make better forecasts. However, formal strategic planning systems do not always produce the desired results.

The next section of the chapter stresses the importance of strategic decision-making by providing an understanding of how cognitive biases impact strategic decision making along with techniques for improving decision making.

The final section of the chapter addresses key characteristics of good strategic leadership that will lead organizations to high performance.

By the end of this chapter, students will understand how strategic leaders can manage the strategy-making process, formulating and implementing strategies that enable a company to achieve a competitive advantage and superior performance. Moreover, they will have an appreciation for how the strategy-making process can go wrong, and what managers can do to make this process more effective.

Learning Objectives

1. Explain what is meant by "competitive advantage."
2. Discuss the strategic role of managers at different levels within an organization.
3. Identify the primary steps in a strategic planning process.
4. Discuss the common pitfalls of planning, and how those pitfalls can be avoided.
5. Outline the cognitive biases that might lead to poor strategic decisions, and explain how these biases can be overcome.
6. Discuss the role strategic leaders play in the strategy-making process.

Opening Case
The Rise of Lululemon

The opening case examines the vision of one person and how he was able to fill a need for stylishly designed clothing for yoga and other sports activities. Lululemon founder Chip Wilson started the company by hiring a top-notch design team to work with technically superior fabrics, and outsourcing manufacturing to low-cost producers in South East Asia. Rather than selling clothing through existing retailers, Wilson elected to open his own stores. The idea was to staff the stores with employees who were themselves passionate about exercise, and could act as ambassadors for healthy living through yoga and related sports such as running and cycling. The first store opened in 2000 and by late 2014 had over 290 stores with sales in excess of 1.7 billion.

Teaching Note:
This Opening Case provides an excellent opportunity to discuss many of the concepts that will be introduced in Chapter 1. For example, Lululemon's superior performance, competitive advantage and company business model strategies included focusing on a market niche where there was an unmet need for stylish, well designed, and high quality athletic wear, satisfying that need through excellence in product design, and managing product inventory to limit supply, spur impulse purchases, and keep prices high.

Figure 1.1: Profitability of Wal-Mart and Competitors, 2003-2012

Lecture Outline

I. Overview

This book argues that the strategies that a company's managers pursue have a major impact on the company's performance relative to that of its competitors. A **strategy** is a set of related actions that managers take to increase their company performance. This book identifies and describes the strategies that managers can pursue to achieve superior performance and provide their companies with a competitive advantage. One of its aims is to give the students a thorough understanding of the analytical techniques and skills necessary to identify and implement strategies successfully.

Strategic leadership is about how to most effectively manage a company's strategy-making process to create competitive advantage. The strategy-making process is the process by which managers select and then implement a set of strategies that aim to achieve a competitive advantage. **Strategy formulation** is the task of selecting strategies, whereas **strategy implementation** is the task of putting strategies into action, which includes designing, delivering, and supporting products; improving the efficiency and effectiveness of operations; and designing a company's organization structure, control systems, and culture.

II. Strategic Leadership, Competitive Advantage, and Superior Performance

Strategic leadership is concerned with managing the strategy-making process to increase the performance of a company, thereby increasing the value of the enterprise to its owners, its shareholders. To increase shareholder value, managers must pursue strategies that increase the profitability of the company and ensure that profits grow (Figure 1.2). To do this, a company must be able to outperform its rivals; it must have a competitive advantage.

Figure 1.2: Determinants of Shareholder Value

A. Superior Performance:

Maximizing shareholder value is the ultimate goal of profit making companies for two reasons:

- Shareholders provide a company with the risk capital that enables managers to buy the resources needed to produce and sell goods and services. **Risk capital** is capital that cannot be recovered if a company fails and goes bankrupt.
- Shareholders are the legal owners of a corporation, and their shares therefore, represent a claim on the profits generated by a company. Thus, mangers have an obligation to invest those profits in ways that maximize shareholder value.

Shareholder value means the returns that shareholders earn from purchasing shares in a company. These returns come from two sources:

- Capital appreciation in the value of a company's shares
- Dividend payments

One way of measuring the **profitability** of a company is by the return that it makes on the capital invested in the enterprise. The return on invested capital (ROIC) that a company earns is defined as its net profit over the capital invested in the firm (profit/capital invested). Net profit means net income after tax. Capital means the sum of money invested in the company—that is, stockholders' equity plus debt owed to creditors. So defined, *profitability is the result of how efficiently and effectively managers use the capital at their disposal to produce goods and services that satisfy customer needs.*

The **profit growth** of a company can be measured by the increase in net profit over time. A company can grow its profits if it sells products in markets that are growing rapidly, gains market share from rivals, increases the amount it sells to existing customers, expands overseas, or diversifies profitably into new lines of business.

Together, profitability and profit growth are the principal drivers of shareholder value. *To both boost profitability and grow profits over time, managers must formulate and implement strategies that give their company a competitive advantage over rivals*. What shareholders want to see, and what managers must try to deliver through strategic leadership, is profitable growth—that is, high profitability and sustainable profit growth.

B. Competitive Advantage and a Company's Business Model

To maximize shareholder value, managers must formulate and implement strategies that enable their company to outperform rivals—that give it a competitive advantage. A company is said to have a **competitive advantage** over its rivals when its profitability is greater than the average profitability and profit growth of other companies competing for the same set of customers. The higher its profitability relative to rivals, the greater its competitive advantage will be. A company has a sustained competitive advantage when its strategies enable it to maintain above-average profitability for a number of years.

A **business model** is managers' conception of how the set of strategies their company pursues should work together as a congruent whole, enabling the company to gain a competitive advantage and achieve superior profitability and profit growth. In essence, a business model is a kind of mental model, or gestalt, of how the various strategies and capital investments a company makes should fit together to generate above-average profitability and profit growth.

III. Industry Differences in Performance

It is important to recognize that in addition to its business model and associated strategies, a company's performance is also determined by the characteristics of the industry in which it competes. Different industries are characterized by different competitive conditions. In some industries, demand is growing rapidly, and in others it is contracting. Some industries might be beset by excess capacity and persistent price wars, others by strong demand and rising prices. Figure 1.3 shows the average profitability, measured by ROIC, among companies in several different industries between 2002 and 2011.

Figure 1.3: Return on Invested Capital (ROIC) in Selected Industries, 2002-2011

A. Performance in Nonprofit Enterprises

Nonprofit enterprises such as government agencies, universities, and charities are not in "business" to make profits. Nevertheless, they are expected to use their resources efficiently and operate effectively, and their managers set goals to measure their performance. The managers of nonprofits need to map out strategies to attain these goals. They also need to understand that nonprofits compete with each other for scarce resources, just as businesses do.

IV. Strategic Managers

In most companies, there are two primary types of managers:

- **General managers**, who bear responsibility for the overall performance of the company or for one of its major self-contained subunits or divisions. The overriding concern of general managers is the success of the whole company or the divisions under their direction; they are responsible for deciding how to create a competitive advantage and achieve high profitability with the resources and capital they have at their disposal.
- **Functional managers**, who are responsible for supervising a particular function, that is, a task, activity, or operation, such as accounting, marketing, etc.

Figure 1.4 shows the organization of a **multidivisional company**, that is, a company that competes in several different businesses and has created a separate self-contained division to manage each. There are three main levels of management—corporate, business, and functional.

Figure 1.4: Levels of Strategic Management

A. Corporate-Level Managers

The corporate level of management consists of the chief executive officer (CEO), other senior executives, and corporate staff. The CEO is the principal general manager. In consultation with other senior executives, the role of corporate-level managers is to oversee the development of strategies for the whole organization. This role includes defining the goals of the organization, determining what businesses it should be in, allocating resources among the different businesses, formulating and implementing strategies that span individual businesses, and providing leadership for the entire organization.

Corporate-level managers also provide a link between the people who oversee the strategic development of a firm and those who own it (the shareholders). Corporate-level managers, and particularly the CEO, can be viewed as the agents of shareholders.

B. Business-Level Managers

A **business unit** is a self-contained division (with its own functions—e.g., finance, purchasing, etc.) that provides a product or service for a particular market. The principal general manager at the business level, or the business-level manager, is the head of the division. The strategic role of these managers is to translate the general statements of direction and intent that come from the corporate level into concrete strategies for individual businesses.

C. Functional-Level Managers

Functional-level managers are responsible for the specific business functions or operations (human resources, purchasing, product development, customer service, etc.) that constitute a company or one of its divisions. Thus, a functional manager's sphere of responsibility is generally confined to one organizational activity, whereas general managers oversee the operation of an entire company or division.

V. The Strategy-Making Process

A. A Model of the Strategic Planning Process

The formal strategic planning process has five main steps:

- Select the corporate mission and major corporate goals.
- Analyze the organization's external competitive environment to identify opportunities and threats.
- Analyze the organization's internal operating environment to identify the organization's strengths and weaknesses.
- Select strategies that build on the organization's strengths and correct its weaknesses in order to take advantage of external opportunities and counter external threats. These strategies should be consistent with the mission and major goals of the organization.
- Implement the strategies.

The task of analyzing the organization's external and internal environments and then selecting appropriate strategies constitutes strategy formulation. In contrast, strategy implementation involves putting the strategies (or plan) into action. This includes taking actions consistent with the selected strategies of the company at the corporate, business, and functional levels; allocating roles and responsibilities among managers (typically through the design of organization structure); allocating resources (including capital and money); setting short-term objectives; and designing the organization's control and reward systems. These steps are illustrated in Figure 1.5.

Figure 1.5: Main Components of the Strategic Planning Process

Each step in Figure 1.5 constitutes a sequential step in the strategic planning process. At step 1, each round, or cycle, of the planning process begins with a statement of the corporate mission and major corporate goals. The mission statement, then, is followed by the foundation of strategic thinking: external analysis, internal analysis, and strategic choice. The strategy-making process ends with the design of the organizational structure and the culture and control systems necessary to implement the organization's chosen strategy.

Some organizations go through a new cycle of the strategic planning process every year. This does not necessarily mean that managers choose a new strategy each year. In many instances, the result is simply to modify and reaffirm a strategy and structure already in place. The strategic plans generated by the planning process generally project over a period of 1 to 5 years, and the plan is updated, or rolled forward, every year. In most organizations, the results of the annual strategic planning process are used as input into the budgetary process for the coming year so that strategic planning is used to shape resource allocation within the organization.

B. Mission Statement

The first component of the strategic management process is crafting the organization's mission statement, which provides the framework—or context—within which strategies are formulated. A mission statement has four main components:

- A statement of the raison d'être of a company or organization—its reason for existence—which is normally referred to as the mission
- A statement of some desired future state, usually referred to as the vision
- A statement of the key values that the organization is committed to
- A statement of major goals

1. Mission

A company's **mission** describes what the company does. According to the late Peter Drucker, an important first step in the process of formulating a mission is to come up with a definition of the organization's business. Essentially, the definition answers these questions—"What is our business? What will it be? What should it be?" The responses to these questions guide the formulation of the mission. To answer the question, "What is our business?" a company should define its business in terms of three dimensions—who is being satisfied (what customer groups), what is being satisfied (what customer needs), and how customers' needs are being satisfied (by what skills, knowledge, or distinctive competencies)? Figure 1.6 illustrates these dimensions.

Figure 1.6: Defining the Business

This approach stresses the need for a *customer-oriented* rather than a *product-oriented* business definition.

2. Vision

The **vision** of a company defines a desired future state; it articulates, often in bold terms, what the company would like to achieve.

3. Values

The **values** of a company state how managers and employees should conduct themselves, how they should do business, and what kind of organization they should build to help a company achieve its mission. Insofar as they help drive and shape behavior within a company, values are commonly seen as the bedrock of a company's organizational culture—the set of values, norms, and standards that control how employees work to achieve an organization's mission and goals.

In one study of organizational values, researchers identified a set of values associated with high-performing organizations that help companies achieve superior financial performance through their impact on employee behavior. These values include respect for the interests of key organizational stakeholders—individuals or groups that have an interest, claim, or stake in the company, in what it does, and in how well it performs. They include stockholders, bondholders, employees, customers, the communities in which the company does business, and the general public.

VI. Major Goals

A goal is a precise and measurable desired future state that a company attempts to realize. The purpose of goals is to specify with precision what must be done if the company is to attain its mission or vision. Well-constructed goals have four main characteristics:

- They are precise and measurable.
- They address crucial issues.
- They are challenging but realistic.
- They specify a time period in which the goals should be achieved, when that is appropriate.

Well-constructed goals also provide a means by which the performance of managers can be evaluated. The primary goal of most corporations is to maximize shareholder returns, and doing this requires both high profitability and sustained profit growth. Thus, most companies operate with goals for profitability and profit growth.

A. External Analysis

The essential purpose of external analysis is to identify strategic opportunities and threats within the organization's operating environment that will affect how it pursues its mission. Three interrelated environments should be examined when undertaking an external analysis—the industry environment in which the company operates, the country or national environment, and the wider socioeconomic or macroenvironment.

Strategy in Action 1.1
Time Inc.: Strategic Analysis

In the mid-2000s, Time Inc. recognized that it needed to change its strategy. Its traditional publications were losing readers. External analysis showed that younger readers were turning to the web for information of the type provided by Time's publications. Internally, Time treated web publication as a separate and less desirable outlet for its content. The Managing Editor of People, Martha Nelson, was the first to see the advantages of a web presence. She merged the two newsrooms and emphasized the need for original content on the web. She stressed the importance of driving traffic to the web and earning advertising revenues. The People model became the template for the other magazines published by Time. Ann Moore, the CEO, neutralized the cultural weakness that hindered online efforts in the past at Time and redirected resources to Web publishing. Web partnerships that merged news channels, magazines, and websites resulted in top online websites. This Web-centric publishing created a focus on energy, resources, and investments toward brands having the ability to obtain digital form audiences.

Teaching Note:
This insert provides an example of how a large, mainstream firm can experience the strategy-making process. An external analysis revealed the need for change, an internal analysis revealed the weaknesses of the firm; the strategic options were identified and implemented. Ultimately, the strategic options were expanded throughout the firm and continued to evolve.

B. Internal analysis

Internal analysis focuses on reviewing the resources, capabilities, and competencies of a company. The goal is to identify the strengths and weaknesses of the company.

C. SWOT Analysis and the Business Model

The comparison of strengths, weaknesses, opportunities, and threats is normally referred to as a **SWOT analysis**. The central purpose is to identify the strategies to exploit external opportunities, counter threats, build on and protect company strengths, and eradicate weaknesses.

The goal of a SWOT analysis is to create, affirm, or fine-tune a company-specific business model that will best align, fit, or match a company's resources and capabilities to the demands of the environment in which it operates. Managers compare and contrast the various alternative possible strategies against each other and then identify the set of strategies that will create and sustain competitive advantage. These strategies can be divided into four main categories:

- *Functional-level strategies*, directed at improving the effectiveness of operations within a company, such as manufacturing, marketing, etc.
- *Business-level strategies*, which encompass the business's overall competitive theme, the way it positions itself in the marketplace to gain a competitive advantage, and the different positioning strategies that can be used in different industry settings—for example, cost leadership, differentiation, etc.
- *Global strategies*, which address how to expand operations outside the home country to grow and prosper in a world where competitive advantage is determined at a global level.
- *Corporate-level strategies*, which answer the primary questions—What business or businesses should we be in to maximize the long-run profitability and profit growth of the organization, and how should we enter and increase our presence in these businesses to gain competitive advantage?

The strategies identified through a SWOT analysis should be congruent with each other. Thus, functional-level strategies should be consistent with, or support, the company's business-level strategies and global strategies.

D. Strategy Implementation

Strategy implementation involves taking actions at the functional, business, and corporate levels to execute a strategic plan. Implementation can include, for example, putting quality improvement programs into place, changing the way a product is designed, positioning the product differently in the marketplace, segmenting the marketing and offering different versions of the product to different consumer groups, implementing price increases or decreases, etc. Strategy implementation entails designing the best organization structure and the best culture and control systems to put a chosen strategy into action. In addition, senior managers need to put a governance system in place to make sure that all within the organization act in a manner that is not only consistent with maximizing profitability and profit growth, but also legal and ethical.

E. The Feedback Loop

The feedback loop indicates that strategic planning is ongoing—it never ends. Once a strategy has been implemented, its execution must be monitored to determine the extent to which strategic goals and objectives are actually being achieved, and to what degree competitive advantage is being created and sustained. Top managers can then decide whether to reaffirm the existing business model and the existing strategies and goals, or suggest changes for the future.

IVII. Strategy as an Emergent Process

The planning model suggests that a company's strategies are the result of a plan, that the strategic planning process is rational and highly structured, and that top management orchestrates the process. Several scholars have criticized the formal planning model for three main reasons:

- The unpredictability of the real world
- The role that lower-level managers can play in the strategic management process
- The fact that many successful strategies are often the result of serendipity, not rational strategizing

A. Strategy Making in an Unpredictable World

Critics of formal planning systems argue that we live in a world in which uncertainty, complexity, and ambiguity dominate, and in which small chance events can have a large and unpredictable impact on outcomes. In such circumstances, they claim, even the most carefully thought-out strategic plans are prone to being rendered useless by rapid and unforeseen change. In an unpredictable world, being able to respond quickly to changing circumstances, and to alter the strategies of the organization accordingly, is paramount.

B. Autonomous Action: Strategy Making by Lower-Level Managers

Another criticism leveled at the rational planning model of strategy is that too much importance is attached to the role of top management, particularly the CEO. An alternative view is that individual managers deep within an organization can—and often do—exert a profound influence over the strategic direction of the firm. Autonomous action may be particularly important in helping established companies deal with the uncertainty created by the arrival of a radical new technology that changes the dominant paradigm in an industry.

Strategy in Action 1.2
A Strategic Shift at Charles Schwab

Charles Schwab had been a successful discount stockbroker company for over twenty years. Its business was handled through branches and a telephone system as well as proprietary software. Then E*Trade came on the scene. E*Trade used the web of online trading; it had no branches, no brokers, no telephone system, thus having a very low cost structure. A software specialist at Schwab, William Pearson, realized the power of the web but couldn't get the attention of his superiors. Eventually he approached Anne Hennegar, a former Schwab manager who now worked as a consultant to the company. Hennegar suggested that Pearson meet with Tom Seip, an executive vice president at Schwab who was known for his ability to think outside the box. Hennegar approached Seip on Pearson's behalf, and Seip responded positively, asking her to set up a meeting. Hennegar and Pearson arrived, expecting to meet only Seip, but to their surprise, in walked Charles Schwab, his chief operating officer, David Pottruck, and the vice presidents in charge of strategic planning and electronic brokerage.

As the group watched Pearson's demo, which detailed how a Web-based system would look and work, they became increasingly excited. A year later, Schwab launched its own Web-based offering, eSchwab, which enabled Schwab clients to execute stock trades for a low flat-rate commission. eSchwab went on to become the core of the company's offering, enabling it to stave off competition from deep discount brokers like E*Trade.

Teaching Note:
An interesting discussion could be generated from this case by asking students to consider what kind of organization culture, policies, structure, leadership, and so on would be necessary to encourage and accept employees' creativity and autonomy. William Pearson was able to overcome the inertia of the system at Charles Schwab. Others may not be so fortunate. Classroom discussion can also be enlivened and humor introduced if you describe, or ask students to describe, other innovations that were not pursued, to disastrous results. For example, when a Harvard MBA student wrote a paper proposing a profit-making delivery service, he hoped his professor would help him find venture financing, but instead received a D on the assignment. The professor believed that no firm would ever be able to deliver packages more efficiently or cheaply than the government-subsidized U.S. Postal Service. The student went on to become the founder of Federal Express.

C. Serendipity and Strategy

Business history is replete with examples of accidental events that help to push companies in new and profitable directions. These examples suggest that many successful strategies are not the result of well-thought-out plans, but of serendipity—stumbling across good things unexpectedly. Serendipitous discoveries and events can open all sorts of profitable avenues for a company. But some companies have missed profitable opportunities because serendipitous discoveries or events were inconsistent with their prior (planned) conception of what their strategy should be.

D. Intended and Emergent Strategies

Henry Mintzberg's model of strategy development provides an encompassing view of what strategy actually is. According to this model, a company's realized strategy is the product of whatever planned strategies are actually put into action (the company's deliberate strategies) and any unplanned, or emergent, strategies (Figure 1.7). In Mintzberg's view, many planned strategies are not implemented because of unpredicted changes in the environment (they are unrealized). Emergent strategies are the unplanned responses to unforeseen circumstances. They arise from autonomous action by individual managers deep within the organization, from serendipitous discoveries or events, or from an unplanned strategic shift by top-level managers in response to changed circumstances.

Figure 1.7: Emergent and Deliberate Strategies

Mintzberg maintains that emergent strategies are often successful and may be more appropriate than intended strategies. Successful strategies can often emerge within an organization without prior planning, and in response to unforeseen circumstances. As Mintzberg has noted, strategies can take root wherever people have the capacity to learn and the resources to support that capacity.

In practice, the strategies of most organizations are likely a combination of the intended and the emergent. The message for management is that it needs to recognize the process of emergence and to intervene when appropriate, relinquishing bad emergent strategies and nurturing potentially good ones. To make such decisions, managers must be able to judge the worth of emergent strategies. They must be able to think strategically. Although emergent strategies arise from within the organization without prior planning, top management must still evaluate emergent strategies.

VIII. Strategic Planning in Practice

Despite criticism, research suggests that formal planning systems do help managers make better strategic decisions. For strategic planning to work, it is important that top-level managers plan not only within the context of the current competitive environment but also within the context of the future competitive environment.

A. Scenario Planning

Scenario planning involves formulating plans that are based upon "what-if" scenarios about the future. In the typical scenario-planning exercise, some scenarios are optimistic and some are pessimistic. Teams of managers are asked to develop specific strategies to cope with each scenario. A set of indicators is chosen as signposts to track trends and identify the probability that any particular scenario is coming to pass. The idea is to allow managers to understand the dynamic and complex nature of their environment, to think through problems in a strategic fashion, and to generate a range of strategic options that might be pursued under different circumstances.

The great virtue of the scenario approach to planning is that it can push managers to think outside the box, to anticipate what they might need to do in different situations. It can remind managers that the world is complex and unpredictable, and to place a premium on flexibility, rather than on inflexible plans based on assumptions about the future. As a result of scenario planning, organizations might pursue one dominant strategy related to the scenario that is judged to be most likely, but they make some investments that will pay off if other scenarios come to the fore (Figure 1.8).

Figure 1.8 Scenario Planning

B. Decentralized Planning

A mistake that some companies have made in constructing their strategic planning process has been to treat planning exclusively as a top-management responsibility. This "ivory tower" approach can result in strategic plans formulated in a vacuum by top managers who have little understanding or appreciation of current operating realities. The ivory tower concept of planning can also lead to tensions between corporate-, business-, and functional-level managers.

Correcting the ivory tower approach to planning requires recognizing that successful strategic planning encompasses managers at all levels of the corporation. Much of the best planning can and should be done by business and functional managers who are closest to the facts; in other words, planning should be decentralized. Corporate-level planners should take on roles as facilitators who help business and functional managers do the planning by setting the broad strategic goals of the organization and providing the resources necessary to identify the strategies that might be required to attain those goals.

IX. Strategic Decision Making

Even the best-designed strategic planning systems will fail to produce the desired results if managers do not effectively use the information at their disposal. One important way in which managers can make better use of their knowledge and information is to understand how common cognitive biases can result in poor decision making.

A. Cognitive Biases and Strategic Decision Making

Humans are not supercomputers, and it is difficult for us to absorb and process large amounts of information effectively. As a result, when we make decisions, we tend to fall back on certain rules of thumb, or heuristics, that help us to make sense out of a complex and uncertain world. However, sometimes these rules lead to severe and systematic errors in the decision-making process. Systematic errors are those that appear time and time again. They seem to arise from a series of **cognitive biases** in the way that humans process information and reach decisions. The following are some of the cognitive biases that exist and that people are prone to:

- The **prior hypothesis bias** refers to the fact that decision makers who have strong prior beliefs about the relationship between two variables tend to make decisions on the basis of these beliefs, even when presented with evidence that their beliefs are incorrect.
    - Moreover, they tend to seek and use information that is consistent with their prior beliefs while ignoring information that contradicts these beliefs.
- Another well-known cognitive bias, **escalating commitment** occurs when decision makers

having already committed significant resources to a project, commit even more resources if they receive feedback that the project is failing.
  - This may be an irrational response; a more logical response would be to abandon the project and move on, rather than escalate commitment.
- A third bias, **reasoning by analogy** involves the use of simple analogies to make sense out of complex problems.
  - The problem with this heuristic is that the analogy may not be valid.
- A fourth bias, **representativeness** is rooted in the tendency to generalize from a small sample or even a single vivid anecdote.
  - This violates the statistical law of large numbers, which says that it is inappropriate to generalize from a small sample, let alone from a single case.
- A fifth cognitive bias is referred to as the **illusion of control**, or the tendency to overestimate one's ability to control events.
  - General or top-level managers seem to be particularly prone to this bias—having risen to the top of an organization, they tend to be overconfident about their ability to succeed.
- The **availability error** is yet another common bias.
  - The availability error arises from our predisposition to estimate the probability of an outcome based on how easy the outcome is to imagine.

B. Techniques for Improving Decision Making

The existence of cognitive biases raises a question—How can critical information affect the decision-making mechanism so that a company's strategic decisions are realistic and based on thorough evaluations? Two techniques known to enhance strategic thinking and counteract cognitive biases are:

- **Devil's advocacy**—this requires the generation of a plan, and a critical analysis of that plan. One member of the decision-making group acts as the devil's advocate, emphasizing all the reasons that might make the proposal unacceptable.
  - In this way, decision makers can become aware of the possible perils of recommended courses of action.
- **Dialectic inquiry**—this is more complex because it requires the generation of a plan (a thesis) and a counter-plan (an antithesis) that reflect plausible but conflicting courses of action. Strategic managers listen to a debate between advocates of the plan and counterplan and then decide which plan will lead to higher performance.
  - The purpose of the debate is to reveal problems with definitions, recommended courses of action, and assumptions of both plans. As a result of this exercise, strategic managers are able form a new and more encompassing conceptualization of the problem, which then becomes the final plan (a synthesis).

Another technique for countering cognitive biases is the **outside view**, which has been championed by Nobel Prize winner Daniel Kahneman and his associates. The **outside view** requires planners to identify a reference class of analogous past strategic initiatives, determine whether those initiatives succeeded or failed, and evaluate the project at hand against those prior initiatives.

X. Strategic Leadership

One of the key strategic roles of both general and functional managers is to use all their knowledge, energy, and enthusiasm to provide strategic leadership for their subordinates and develop a high-performing organization. Several authors have identified a few characteristics of good strategic leaders that do lead to high performance:

- Vision, eloquence, and consistency
- Articulation of a business model
- Commitment
- Being well informed
- Willingness to delegate and empower
- Astute use of power
- Emotional intelligence

A. Vision, Eloquence, and Consistency

One of the key tasks of leadership is to give an organization a sense of direction. Strong leaders seem to have a clear and compelling vision of where the organization should go, are eloquent enough communicate this vision to others within the organization in terms that energize people, and consistently articulate their vision until it becomes part of the organization's culture.

B. Articulation of the Business Model

Another key characteristic of good strategic leaders is their ability to identify and articulate the business model the company will use to attain its vision. A business model is managers' conception of how the various strategies that the company pursues fit together into a congruent whole. Although individual strategies can take root in many different places in an organization, and although their identification is not the exclusive preserve of top management, only strategic leaders have the perspective required to make sure that the various strategies fit together into a congruent whole and form a valid and compelling business model.

C. Commitment

Strong leaders demonstrate their commitment to the visions and business models by actions and words, and they often lead by example.

D. Being Well Informed

Effective strategic leaders develop a network of formal and informal sources who keep them well informed about what is going on within the company. Using informal and unconventional ways to gather information is wise because formal channels can be captured by special interests within the organization or by gatekeepers—managers who may misrepresent the true state of affairs to the leader.

E. Willingness to Delegate and Empower

High-performance leaders are skilled at delegation. They recognize that unless they learn how to delegate effectively, they can quickly become overloaded with responsibilities. They also recognize that empowering subordinates to make decisions is a good motivational tool and often results in decisions being made by those who must implement them.

F. The Astute Use of Power

In a now-classic article on leadership, Edward Wrapp noted that effective leaders tend to be very astute in their use of power. He argued that strategic leaders must often play the power game with skill and attempt to build consensus for their ideas rather than use their authority to force ideas through; they must act as members of a coalition or its democratic leaders rather than as dictators.

G. Emotional Intelligence

Emotional intelligence is a term that Daniel Goleman coined to describe a bundle of psychological attributes that many strong and effective leaders exhibit:

- Self-awareness—the ability to understand one's own moods, emotions, and drives, as well as their effect on others.
- Self-regulation—the ability to control or redirect disruptive impulses or moods, that is, to think before acting.
- Motivation—a passion for work that goes beyond money or status and a propensity to pursue goals with energy and persistence.
- Empathy—the ability to understand the feelings and viewpoints of subordinates and to take those into account when making decisions.
- Social skills—friendliness with a purpose.

According to Goleman, leaders who possess these attributes—who exhibit a high degree of emotional intelligence—tend to be more effective than those who lack these attributes. Their self-awareness and self-regulation help to elicit the trust and confidence of subordinates. In Goleman's view, people respect leaders who, because they are self-aware, recognize their own limitations and, because they are self-regulating, consider decisions carefully. Goleman also argues that self-aware and self-regulating individuals tend to be more self-confident and therefore better able to cope with ambiguity and more open to change. A strong motivation exhibited in a passion for work can also be infectious, helping to persuade others to join together in pursuit of a common goal or organizational mission.

Teaching Note: Ethical Dilemma
This question should solicit an interesting discussion of various viewpoints regarding whether to aim toward accomplishing a large bonus and promotion or keep with the mission statement and maintain the importance of acting with integrity at all times. The instructor should explain, in such a dilemma that while satisfying the goals is important, employees should not lower lending standards and should not lend money to people whose

ability to meet their mortgage payments is questionable.

Answers to Discussion Questions

1. What do we mean by strategy? How is a business model different from a strategy?

   Strategy is an action a company takes to attain superior performance. Strategy also involves both thinking and doing. From Mintzberg's definition of strategy as a pattern in a stream of decisions or actions, strategy is more than what a company intends to do; it is also what it actually does. That is to say, a company's strategy is the product of (a) that part of its intended strategy that is actually realized and (b) its emergent strategy. A business model is managers' conception of how the various strategies that the company pursues fit together into a congruent whole.

2. What do you think are the sources of sustained superior profitability?

   Sustained superior profitability results when a company is able to increase profits, either by increasing revenues or decreasing expenses or both, and when that ability is difficult or impossible for competitors to imitate. Sustained superior profitability is most likely to occur when the advantages are intangible, such as management insight, disciplined cost cutting by employees, or a culture that nourishes creativity. Intangible resources are much more difficult to imitate than tangible ones, and thus provide a sustainable advantage. However, no firm can sustain an advantage forever. The advantage itself will tend to weaken over time and competitors will learn to imitate that advantage or develop other advantages of their own that will counteract the power of the original advantage.

3. What are the strengths of formal strategic planning? What are its weaknesses?

   A formal strategic planning process results in a systematic review of all the external and internal factors that might have a bearing on the ability of the company to meet its strategic objectives. Formally identifying strengths, weaknesses, opportunities, and threats is a good way of alerting strategic managers to what needs to be done if the firm is to fulfill its strategic mission.

   However, like any rational process, strategic planning is limited by the fallibility of human decision makers. In particular, strategic managers may fall victim to the phenomenon of groupthink and to their own cognitive biases. Thus, supposedly rational decisions can turn out to be anything but rational. This hazard can be minimized, however, if the organization uses decision-making techniques such as devil's advocacy or dialectic inquiry.

   In addition, in a complex and uncertain world characterized by rapid change, strategic plans can become outdated as soon as they are made. In such circumstances, the company's plan can become a policy straitjacket, committing it to a course of action that is no longer appropriate. Change is something that cannot be insured against. Consequently, flexible, open-ended plans are perhaps the best way of giving the company room to maneuver in response to change. Moreover, consistent vision and strategic intent are probably more important than detailed strategic plans. The strategies that a company adopts might need to change with the times, but the vision can be more enduring.

4. To what extent do you think that cognitive biases may have contributed to the global financial crisis that gripped financial markets in 2008–2009? Explain your answer.

   Cognitive biases prevent rational action and prevent leaders from being mentally prepared for trouble. Behavioral economists such as the Nobel prize-winner, Daniel Kahneman, have documented cognitive biases in markets, such as over-optimism, over-pessimism, deal frenzy, failure to ignore sunk costs, and so on. Hence, the CEOs end up making poor acquisition decisions, often paying far too much for the companies they acquire. Subsequently, servicing the debt taken on to finance such an acquisition makes it all but impossible to make money from the acquisition.

5. Discuss the accuracy of the following statement: Formal strategic planning systems are irrelevant for firms competing in high-technology industries where the pace of change is so rapid that plans are routinely made obsolete by unforeseen events.

   Formal strategic planning systems are not at their best in situations with rapid and unpredictable change. Formal systems are time-consuming, and may not be able to provide answers quickly enough when time is very short. Also, formal systems depend upon detailed estimates and forecasts, which are very difficult to do well when conditions are chaotic.

   Nevertheless, formal systems may still be useful in some ways, even in these challenging environments. For example, formal systems are often associated with detailed and directive plans, but they may also be used to prepare flexible, open-ended plans that are more appropriate for rapidly changing environments. Also, the activities of formal planning—gathering data, preparing forecasts, generating and considering multiple alternatives, and so on—are themselves good preparation for making strategic choices, and thus could be useful in any type of environment.

6. Pick the current or a past president of the United States and evaluate his performance against the leadership characteristics discussed in the text. On the basis of this comparison, do you think that the president was/is a good strategic leader? Why?

   Students' answers will vary. Answering this question calls for students to rate the president according to the six main characteristics of good strategic leaders discussed in the text. There is no right answer to this question. Students' political biases will undoubtedly color the answers they give. It is the exercise itself that is important. Only with the passage of time will a more objective judgment of a president's leadership skills be possible.

MindTap

Cengage offers additional online activities, assessments and resources inside MindTap, our online learning platform. The following activities can be assigned within MindTap for students to complete.

Guided Case

Guided Case exercises are a series of multiple choice questions designed to focus on the concepts from the chapter utilizing the case study analysis steps, such as history, internal analysis, external analysis, SWOT analysis, identification of corporate-level strategy and business-level strategy, company structure and control systems and finally making strategic recommendations.

HomeGrocer.com

Terry Drayton and Mike McDonald founded HomeGrocer in 1994. In 1998 their website went live. A number of other companies were also attempting the online grocery retail model. This case takes students through the challenges HomeGrocer faced as they tried to perfect a new business model. HomeGrocer faced many issues as it tried to grow and reach a competitive advantage. Cash flow issues, pressure from shareholders, competition, and the stock market crash in 2000 would prove to be too much to overcome. Students will be introduced to many of the concepts in this chapter including SWOT analysis, corporate-level strategy and cognitive biases.

Experiential Exercise
Prepare Your Start-up for Success

The purpose of this exercise is to practice organizing a strategic planning process. In this exercise, you will work as a team to propose a process and identify the elements that will make the program successful or lead to flawed planning. In this group project, you will have the opportunity to practice valuable strategic management skills, including: Planning, Organization, and Critical Thinking. Students will work on an idea for a new business - a **service that collects college classwork for individual business students into a portfolio the students can use later to build their resumes and demonstrate their experience. Students will submit** a 3-5 page executive summary that includes the vision, mission and participants of the company as well as a SWOT analysis.

Video Quiz

The video quiz offers additional opportunities for students to apply the concepts in the chapter to a real-world scenario as it is described in news reports.

The Humble CEO of Japan Airlines, Haruka Nishimatsu

This video describes how the CEO of Japan Airlines, Haruka Nishimatsu embodies several of the characteristics of a high performing strategic leader. Nishimatsu’s open-door policy, knocking down office walls, eating with employees in the cafeteria and meeting with managers who have ideas is a way to decentralize planning or promote strategy as an emergent process within his organization.

Closing Case
The Evolution of Wal-Mart

Wal-Mart is one of the most extraordinary success stories in business history. Started in 1962 by Sam Walton, Wal-Mart has grown to become the world's largest corporation. In 2014, the discount retailer—whose mantra is "everyday low prices"—had sales of more than $475 billion, close to 11,000 stores in 27 countries, and more than 2.2 million employees.

Teaching Note:
This case illustrates a number of concepts from the chapter, including many successful strategic ideas, the evolution of strategy over time, and the impact of environmental and internal forces on strategic decision-making and strategic success. It also emphasizes the importance of strategic leadership and a thorough analysis when formulating strategies.

Answers to Case Discussion Questions

1. What was Sam Walton's original strategic vision for Wal-Mart? How did this enable the company to gain a competitive advantage?

   Founder Sam Walton discovered that people living in rural areas would drive an hour to his store vs 3 hours to a major city to shop.

2. How did Wal-Mart continue to strengthen its competitive advantage over time? What does this teach you about the source of a long-term competitive advantage?

   As Wal-Mart grew larger it continued its competitive advantage the purchasing power of the company enabled it to drive down process to suppliers. Walmart also implemented sophisticated product tracking technology allowing it to use that data to adjust inventory and reduce overstocking.
   Wal-Mart's strategies show that if a company is going to gain a long term competitive advantage, it's strategies must be compatible and they must create increased profitability and profit growth over a number of years, not just in the short term.

3. By the early 1990s, Wal-Mart was encountering limits to growth in the US. How did it overcome these limits to growth? Explain how the expansion moves that Wal-Mart made in the 1990s made economic sense and helped to create value for the company's shareholders.

   Wal-Mart started to diversify into the grocery business, opening 200,000-square-foot supercenter stores that sold groceries and general merchandise under the same roof. Wal-

Mart also diversified into the warehouse club business with the establishment of Sam's Club. The company began expanding internationally in 1991 with its entry into Mexico.

4. Wal-Mart is once again encountering limits to growth. Why do you think this is the case? What might Wal-Mart do to push back these limits?

   Wal-Mart is encountering limits to growth in the U.S. because of a saturated market, but it may be facing limits to growth for different reasons overseas. Wal-Mart's key strategy is to be a low cost leader. Right now, it does that by keeping operational costs low, including paying low wages to employees. Wal-Mart may need to find other ways to reduce costs in the future in order to maintain its competitive advantage.

5. How much of Wal-Mart's strategy do you think was planned at the outset, and how much evolved over time in response to circumstances? What does this suggest to you about the nature of strategy development?

   Wal-Mart's low cost strategy was planned at the beginning of the company, but other strategic decisions, such as the determination to go into groceries, have evolved in response to environmental changes. It is critically important for companies to continuously monitor their environments and to change their strategies to keep up with changes in those environments.